No. 301

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JOHN T. FEY, Clerk

In the Supreme Court of the United States

OCTOBER TERM, 1957

UNITED STATES OF AMERICA, *Petitioner*

v.

DRAGON CEMENT COMPANY, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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CITATIONS

CASE:

United States v. *Cherokee Brick & Tile Co.*, 218 F. 2d 424 . . 5

STATUTE:

Internal Revenue Code of 1939:

Sec. 23(m) (26 U.S.C. 1952 ed., Sec. 23(m)) 5, 15

Sec. 23(n) (26 U.S.C. 1952 ed., Sec. 23(n)) 5, 15

Sec. 114(b) (26 U.S.C. 1952 ed., Sec. 114(b)) 5, 15a

MISCELLANEOUS:

Treasury Regulations 111, Sec. 29.23(m)-1 . . . . . 17a

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The Attorney General,[1] on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the First Circuit in the above-entitled case.

OPINIONS BELOW

The opinion of the District Court (R. A39-A45)[2] is reported at 144 F. Supp. 188. The opinion of the Court of Appeals (Appendix A, *infra*, pp. 1a-14a) is not yet officially reported.

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[1] For personal reasons, the Solicitor General has disqualified himself from participating in this litigation.

[2] "R." refers to the Appendix to the Brief for Plaintiff-Appellant, and "Supp. R." to the Appendix to the Brief for Defendant-Appellee.

JURISDICTION

The judgment of the Court of Appeals was entered on May 14, 1957. (Appendix A, *infra*, p. 14a.) The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether "gross income from mining", on the basis of which percentage depletion for mineral deposits is allowable under Sections 23(m) and (n) and 114 (b)(4) of the Internal Revenue Code of 1939, includes income derived from manufacturing merely because the mine owner, in addition to engaging in mining activities, transforms the mineral into a manufactured product and sells it as such.

The answer depends on whether the mine owner's manufacturing operations are to be considered "ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product", within the meaning of Section 114(b)(4)(B).

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of Sections 23(m) and (n) and 114(b)(4) of the Internal Revenue Code of 1939 and of Section 29.23(m)-1 of Treasury Regulations 111 are set forth in Appendix B, *infra*, pp. 15a-22a.

STATEMENT

Taxpayer[3] owns and operates two quarries from which it extracts a calcium carbonate rock, commonly

[3] The Dragon Cement Company, Inc., by a merger effective November 30, 1951, became the successor to the Lawrence Portland Cement Company. (R. A17.) For convenience, the predecessor and successor corporations are referred to as the "taxpayer".

known as cement rock, suitable for conversion into cement. Its operations begin with drilling and primary blasting from the face of the quarry to obtain the mineral product, cement rock. The cement rock is then broken into manageable size by secondary blasting and loaded by shovels into dump trucks, which carry the cement rock to an inclined railway. It is there deposited into dump rail cars for transportation to the plant. The cars, in turn, dump the cement rock into a large primary crusher, which reduces the size of the extracted rock to pieces of a maximum dimension of about eight inches. After primary crushing, the crushed cement rock is carried by a conveyer belt to a secondary crusher which further reduces the size of the rock. A conveyor belt then carries the cement rock to a shed. At this point, the rock is picked up by an overhead crane and deposited in a hopper for screening. The screened cement rock is then fed to a ball mill, where it is ground with water to a proper fineness known as "slurry". The material is then conveyed to a wet "slurry" tank where it is kept in suspension by a revolving paddle mechanism. The "slurry" is next run off to filters, where much of the water is removed, and the resulting filter cake is conveyed by belt to rotary kilns. The filter cake is then placed in the upper end of the kilns, which take the form of long rotating cylinders set at a slight inclination, the filter cake gradually traveling to the lower end of the kiln. Hot gases from a flame at the lower end draw off water from the filter cake and burn the remaining material to a dense clinker. The clinker is carried to a grinding mill where it is ground to the fineness of cement. Finally, the cement is placed in

silos from which it is loaded and shipped in bags or in bulk. (R. A18-A20.)

In its return for the taxable period ending November 30, 1954, taxpayer computed its deduction for depletion of the mineral deposit by applying the statutory percentage (10% on cement rock) to that portion of the gross income realized from the sale of the finished cement product which was allocable to its mining, as distinguished from its manufacturing, operations.[4] However, taxpayer subsequently filed a claim for refund, alleging that it should have computed the percentage depletion deduction in its return on the basis of the total sales price of the finished product, without diminution for the portion attributable to its manufacturing (*i.e.*, the kiln and post-kiln) processes.[5] (Supp. R. 51-53.) The claim was denied, and suit for refund followed. (R. A4-A14, A18.) The District

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[4] The allocation was made by obtaining the percentage resulting from dividing the cost incurred up to the kiln-feed stage by the total cost, and multiplying the gross income from cement sales by this percentage. Since taxpayer used certain purchased materials in its end product (in addition to the cement rock it mined), the allocated gross income was then multiplied by the percentage obtained by dividing the direct costs applicable to cement rock only (plus depreciation and overhead) to the kiln-feed stage by the direct cost of all materials (plus depreciation and overhead) to the kiln-feed stage in order to obtain the gross income from mining the cement rock. The resulting figure was then multiplied by the applicable statutory percentage (10%) to obtain a depletion allowance of $204,857. (Supp. R. 51-53.)

[5] Taxpayer's refund claim was based on a depletion allowance computed as follows: the gross income from cement sales was multiplied by the percentage obtained by dividing the tonnage of cement rock mined by the tonnage of all material handled, in order to obtain gross income from cement rock mined, to which taxpayer applied the applicable percentage to obtain a claimed allowance of $795,853. (Supp. R. 51-53.)

Court, on cross motions for summary judgment, dismissed the complaint and entered judgment as to this issue in favor of the United States. (R. A45.) The Court of Appeals reversed. (Appendix A, *infra*, pp. 1a-14a.)

REASONS FOR GRANTING THE WRIT

This case presents the same important question of statutory construction as *United States* v. *Merry Brothers Brick and Tile Co., et al.*, No. 220, in which a petition for a writ of certiorari was filed on June 24, 1957, namely, the proper basis for computing percentage depletion for mineral deposits under Sections 23(m) and (n) and 114(b)(4) of the Internal Revenue Code of 1939. (Appendix B, *infra*, pp. 15a-17a.) While the *Merry* and companion cases involve clay, and the instant case involves a calcium carbonate (cement rock), the problem is the same, and it was so considered by the court below. Indeed, in holding that "gross income from mining"—the base, under the statute, to which percentage depletion is applicable—extends to income derived from manufacturing operations, the court below expressly followed the interpretation placed on the statute by the Fifth Circuit in *United States* v. *Cherokee Brick & Tile Co.*, 218 F. 2d 424 (Appendix A, *infra*, pp. 10a-11a). The views adopted in *Cherokee* were reaffirmed by the Fifth Circuit in the *Merry* case.

For the reasons set forth in our petition in the *Merry* and companion cases, we submit that the decision below, which rejected the Treasury's long-standing interpretation of the statute, is erroneous. The *Cherokee* rule, if it prevails, will have heavy impact

upon the revenue.[6] The same considerations which call for review of the Fifth Circuit cases now pending on petition (No. 229) make the instant case an equally appropriate one for grant of the writ.

Respectfully submitted,

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[6] A survey conducted by the Internal Revenue Service (see Appendix C to the *Merry* petition) indicates that there are numerous cases now in litigation or pending administratively, involving percentage depletion allowable with respect to calcium carbonates and other minerals, in which mine owners are attempting to apply the rule followed by the court below; and that the tax loss which would result from application of the rule is very substantial.

* See footnote 1, *supra*.